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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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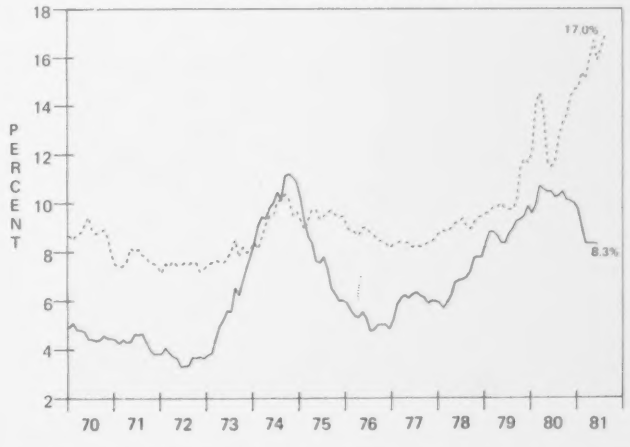
Some Ease . . .

The modest reduction in the prime rate last week from 20.5 to 20 per cent has prompted a flurry of speculation that the Federal Reserve has started to loosen the monetary reins. The Federal Reserve, however, continues to insist that the basic thrust of monetary policy remains unchanged. But on at least one point, there can be no disagreement—short-term interest rates have moved significantly lower during the past month, especially the Federal funds rate. This key rate declined by almost 250 basis points during the four weeks ending September 16, and now stands at its lowest point since April. Other interest rates moved in sympathy with the funds rate, with certificate of deposit, commercial paper and Treasury bill rates all moving markedly lower.

In the bond markets, in contrast, the trend in interest rates was up, reflecting primarily heightened investor concern over the bond market impact of another sizable Federal government deficit in fiscal 1982. Top-quality corporate yields increased from 45 to 75 basis points during the four weeks ending September 16, while long-term U.S. government and municipal bond rates also moved sharply higher. The extent of the current disarray is clearly highlighted

12-MONTH PERCENT CHANGE IN PCE DEFLATOR (LINE) VS. NEW ISSUE AA UTILITY RATE (DOT)



by the almost ten percentage point real interest rate now prevailing on new issue, double-A rated utility bonds. Although this level of real interest rates is approximately four times greater than those which existed during the 1970s, it has been insufficient to prompt widespread retail buying interest.

But despite the disarray in the bond markets, the fundamentals continue to suggest that some decline in money and bond market interest rates could occur sometime soon. Inflation rates, for example, have clearly moved to a lower level—the uptick in August's consumer price index notwithstanding. This blip resulted primarily from a rise in home prices and mortgage interest rates. When the influence of these two components is eliminated from the index, the 10.7 per cent rate of inflation during the 12-month period ending July, 1981 is transformed into a 7.6 per cent rate of rise during the period.

. . . Less Squeeze . . .

In the economy, it appears likely that the pace of business has slowed over the summer, and will remain subdued during the remainder of this year. Continuing weakness in the housing sector, autos, business plant and equipment spending and net exports all point to sluggish economic growth. In addition, unemployment insurance claims are on the rise once again which, together with the 0.4 per cent month-over-month downturn in industrial production in August, could herald a jump in the unemployment rate, a slowing of personal income growth and a downturn in household spending. All of these developments could lead to a slowdown in private sector credit demands and a downturn in interest rates.

Even investor concern over the impact of likely Federal budget deficits on interest rates may be unjustified, since the Administration seems determined to implement further spending reductions. In the interim, however, concern over Federal government finances has not been misplaced. Soaring interest and income security outlays as well as stepped-up defense spending, seriously jeopardize the ability of the Administration to achieve a $42 billion budget deficit in fiscal 1982, and, in fact, the actual total may be closer to $60 billion. This suggests that the financial markets will have to absorb another large supply of Treasury and Federal

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agency securities in the coming year, which in the absence of any significant upturn in demand for these issues, will place downward pressures on their prices and upward pressures on yields.

On a more positive note, the Federal Reserve continues to achieve a certain measure of success in controlling the growth of the monetary aggregates. The narrowly defined monetary aggregate M1-B, for example, is still expanding at an annual rate well below its 1981 lower target boundary of six per cent (4.6 per cent year-to-date growth). As of the latest week, it stood almost $11 billion below its lower target boundary and a sizable $21 billion below its upper limit. Even the growth of M2 is only slightly above its 1981 upper target boundary of nine per cent (9.3 per cent year-to-date), despite the rapid expansion of money market funds.

. . . Equals Lower Rates

In fact, with the exception of M3, the monetary aggregates are now expanding at annual rates either near or below the central bank's target ranges. This, in turn, has permitted a slight easing of Federal Reserve monetary policy. The growth of non-borrowed reserves—the building blocks of the money supply—has accelerated sharply over the past quarter, borrowings at the Federal Reserve's discount window have trended lower, the banking

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 9/9/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov't and Agencies Owned Outright & RPs	132.277	– 1.324	+ 4.857
Loans to Depository Inst.	1.585	+ .137	+ .991
Float	2.277	– .474	– 3.719
Total Reserve Bank Credit	144.365	– 2.224	+ 5.317
Treasury Deposits with Federal Reserve Banks	2.767	– .652	– .266
Currency Outside Banks	123.780	– .030	+ 5.639
Member Bank Reserves:			
Required	39.307	– 1.524	– .739
Excess (Deficiency)	.261	+ .008	+ .083
Total Reserves Held	39.568	– 1.516	– .656
Net Borrowed Reserves	1.107	+ .158	+ .705
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	92.570	+ .732	+ 8.585

Monetary Aggregates †		% Change Since Three Months Ago*	% Change Since Year Ago
M1-B	432.9	+ 2.2‡	+ 6.0‡
M2 (August '81)	1,778.8	+ 8.1	+ 8.9
M3 (August '81)	2,118.9	+ 11.6	+ 11.7
L (May '81)	2,476.7	+ 7.3	+ 11.0

†Seasonally adjusted. *Seasonally adjusted annual rate ‡Four-week moving average.

New York Money Market

Offering Rates 9/18/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	14.28%	14.32%	14.06%
* Federal Agencies	14.54	15.58	16.29
* Project Notes–Taxfree (46% Taxable Equivalent)	17.13	17.22	17.31
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	16.40	16.63	16.75

‡Finance Company Paper–Prime

5- 14 days	14.50%
15- 29 days	15.00
30- 59 days	15.38
60- 89 days	15.50
90-179 days	15.50
180-239 days	14.50
240-270 days	14.00

‡* Bankers' Acceptances

Oct.	15.70%
Nov.	15.70
Dec.	15.70
Jan.	15.70
Feb.	15.60
Mar.	15.40

‡Industrial Paper–Prime

30- 89 days	15.38%
90-120 days	15.63

†Federal Funds Effective Rate 15.70%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'81	$ 2,886	$ 2,853	$ 2,565
Gross National Product (1972 Dollars)*	2nd Q'81	$ 1,510	$ 1,516	$ 1,463
Percent Change, Annual Rate	2nd Q'81	– 1.6%	8.6%	– 9.9%
Change in Consumer Prices (all urban consumers)*	Jul '81	14.4%	8.4%	1.2%
Change in Producer Prices*	Aug '81	3.6%	4.8%	14.4%
Civilian Employment (Thousands of Persons)†	Aug '81	98,944	98,962	97,003
Unemployment as % of Civilian Labor Force†	Aug '81	7.2%	7.0%	7.6%
Personal Income*	Aug '81n	$ 2,446	$ 2,419	$ 2,179
Leading Indicators Composite Index (1967=100)†	Jul '81	133.7	133.9	128.1
Industrial Production Index (1967=100) †	Aug '81n	152.8	153.4	142.2
Net Change in Consumer Installment Credit†	Jul '81	$ 1.95	$ 1.93	–$ 1.20
U.S. Merchandise Trade Balance †	Jul '81	–$ 0.54	–$ 2.10	–$ 0.87
Plant and Equipment Expenditures*	4th Q'81	$332.69(a)	$322.88(a)	$299.58
Private Housing Starts (Thousands of Units)*	Aug '81n	937	1,049	1,411
New Construction Expenditures*	Jul '81	$ 235.1	$ 238.7	$ 216.4
Total Business Inventories†	Jul '81n	$ 499.5	$ 494.2	$ 466.8
Total Business Sales†	Jul '81n	$ 354.6	$ 354.4	$ 315.6

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

system's net free reserve position has improved markedly compared with three months ago and the Federal funds rate has been consistently trading in the 15½-16 per cent range recently. This key rate is now over four full percentage points lower than the 20 per cent rate prevailing earlier this summer. It was in response to these signs of ease, as well as a lower cost of funds that the banks, last week, cautiously dropped their base lending rate to 20 per cent.

To date, however, much of the downward interest rate impact of this slight shift toward monetary ease has been offset by a sharp surge in short-term business credit demands. During the 13 weeks ending September 2, for example, commercial and industrial loans outstanding at large weekly reporting banks rose a seasonally adjusted $9.7 billion, or at a more than 20 per cent seasonally adjusted annual rate. Commercial paper issuance by nonfinancial corporations, an alternative source of short-term credit for many companies, has also soared. Outstanding nonfinancial company paper increased at a seasonally adjusted annual rate of more than 55 per cent during the same period.

The Dollar Moves Lower, Too

The easing of some U.S. interest rates has had an effect on the exchange rate of the dollar as well.

(Continued on back page)

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (9/2/81)	131,431	+ 1,253	+36,913
New York City (9/2/81)	31,292	+ 433	+ 8,999
Commercial Paper (9/2/81)	153,896	– 1,152	+31,887

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/2/81)	184,894	+ 2,052	+23,133
New York City (9/2/81)	54,197	+ 804	+ 6,072

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (9/2/81)	452,152	+ 4,671	+47,678
New York City (9/2/81)	108,566	+ 2,698	+15,666

Financial Markets

	Friday 9/18/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	14.40%	– .85	+ 3.98
180-Day Bills†	15.10	– 1.16	+ 4.11
Longest Bills†	15.75	– .67	+ 4.37
Recent Issues:			
16s 9/30/83 (When Issued)	16.00	NA	
14s 6/30/85	15.69	– .34	
14⅞s 8/15/91	14.82	– .24	
13⅞s 5/15/11	14.18	– .27	
Municipals:			
Bond Buyer–20 Bond Index* (9/17/81)	12.79%	– .42	+ 3.81
Blue List Total ($ Million)	$ 562	– $ 22	– $ 129
30-Day Visible Supply ($ Million)	$1,409	– $184	– $ 746
Total	$1,971	– $206	– $ 875
Corporates:			
Moody's Aa Composite (9/17/81)	15.72%	– .23	+ 3.23
30-Day Visible Supply ($ Million)	$8,534	+ $ 87	+ $4,423
Stocks:			
Dow-Jones Averages:			
Industrials	836.19	– 36.62	– 127.55
Transportation	345.51	– 12.89	– 1.01
Utilities	104.24	– 3.03	– 8.10
65 Stocks	327.08	– 12.87	– 28.90
Standard and Poor s 500 Stocks	116.26	– 5.35	– 12.99
N.Y.S.E. Composite Index	67.27	– 3.05	– 7.54
N.Y.S.E. Avg. Daily Vol. for Week (000's)	42,462	– 2,336	– 14,188

* 46% Taxable equivalent 23.69%.

† Bond equivalent.

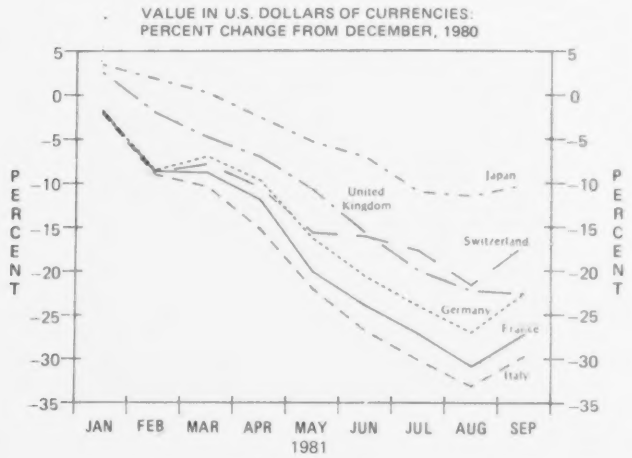
International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 9/18/81	Week Ago
Overnight	15.88%	16.88%
1 month	16.50	17.50
3 month	17.38	18.00
6 month	17.63	18.25
1 year	17.10	17.88
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	15.55%	15.45%
Long Term (7 to 15 yrs.)	15.40	15.35

FOREIGN EXCHANGE SPOT RATES

New York Opening (9/18/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02687	37.21
Canada	.8330	1.2005
Denmark	.1383	7.2325
France	.1833	5.4550
Germany	.4407	2.2690
Italy	.0008654	1155.50
Japan	.004410	226.75
Mexico	.03995	25.03
Netherlands	.3972	2.5175
Switzerland	.5132	1.9485
U.K.	1.8320	.545[illegible]

During the past month, the dollar has weakened against the other major trading currencies (see chart). The German mark, for example, which had dropped to 2.57 to the dollar in mid-August was



trading at about 2.35 to the dollar last week—an appreciation of almost ten per cent in one month. However, to place this recovery in perspective, the D-mark is still some 22 per cent below its December, 1980 level against the dollar. The Japanese yen which was, relatively speaking, the strongest major currency against the dollar since the end of 1980 (down only ten per cent) has also recovered from its low point of 245 yen to the dollar in early August to the 225 yen to the dollar range last week—an improvement of close to eight per cent from its low point. The yen is less interest rate sensitive than the other principal currencies.

It would be premature to conclude that the dollar is entering an extended period of weakness in that exchange rates will return soon to the levels experienced in 1979 and early 1980. For one thing, most economists expect that U.S. real interest rates will remain high at least into early 1982 and will remain attractive when compared with similar interest rates in Europe and Japan. For another, other factors influencing exchange rates such as balance of payments developments and political stability will continue to favor the dollar through the end of 1981 at least. The U.S. anticipates a substantial current account surplus this year and capital inflows are expected to continue as long as interest rates remain attractive. Political instability and uncertainty in the Middle East and Eastern Europe will also favor the dollar.

The extreme sensitivity of the dollar exchange rate to changes in real interest rates compared with other influential factors is a recent phenomenon generated by the very large spread between real interest rates on dollar-denominated financial assets and foreign rates. Consequently, as U.S. interest rates fall and the real interest rate spread between U.S. and foreign investments narrows, the other factors affecting exchange rates will again increase in importance. As a result, a period of relative exchange rate stability may develop. Stability of exchange rates between the dollar and other currencies will be beneficial to the U.S. economy. Although a strong dollar helps in the fight against inflation by keeping the cost of imports down, it also encourages an increase in the volume of imports affecting the U.S. merchandise trade balance. Further, a strong dollar makes U.S. exports more expensive reducing the volume of our exports, adding to the trade deficit and reducing the number of jobs created by the export sector. Exchange rates in a floating rate system are in a constant process of adjustment seeking the balance somewhere between a "weak" level and a "strong" level which generates compensating benefits to the national economy. H

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